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DE RUEHSN #0513 1591747
ZNR UUUUU ZZH
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FM AMEMBASSY SAN SALVADOR
TO RUEHC/SECSTATE WASHDC 1197
INFO RUEHZA/WHA CENTRAL AMERICAN COLLECTIVE
RUCPDOC/USDOC WASHDC
RUEATRS/DEPT OF TREASURY WASHINGTON DC
RUEHLMC/MILLENNIUM CHALLENGE CORP WASHINGTON DC

UNCLAS SAN SALVADOR 000513

STATE PASS USAID/LAC
STATE ALSO PASS USTR

SIPDIS
SENSITIVE

E.O. 12958: N/A
TAGS: EFIN ECON SOCI PGOV ES
SUBJECT: EL SALVADOR REALLOCATES LOANS, APPROVES DEBT TO ADDRESS BUDGET CRISIS

¶1. (SBU) Summary. On May 22, the Legislative Assembly unanimously approved the reallocation of $950 million in international loans and the issuance of $1.8 billion in new medium and long term debt to replace short-term debt in order to face the effects of the international financial crisis in El Salvador. On May 26, the government sold $300 million in Treasury Bills in order to cover short term expenditures and unpaid bills. These approvals are the first step in addressing a $1 billion-plus budget deficit for 2009. The Funes Administration is still negotiating new loans with the International Financial Institutions. End summary.

¶2. (U) On May 22, the Legislative Assembly unanimously approved approximately $2.75 billion in debt reallocation and issuance. The voting was preceded by a protocol signed by (now former) President Antonio Saca, President Mauricio Funes, Alianza Republicana Nacionalista (ARENA) President Alfredo Cristiani, and the Farabundo Marti Front for the National Liberation Party (FMLN) General Coordinator Medardo Gonzalez. All agreed to comply with the decrees and to support the efforts of the new government in obtaining new financing.

¶3. (U) The decrees allow the government to reallocate $950 million in loans from the Inter-American Development Bank (IDB) and the World Bank (WB). Originally, $650 million of this loan package was to be used to cover El Salvador's 2011 Eurobond debt, but the funds will now be used "to face the fiscal needs derived of the reduction in tax revenues collection, in order to protect budget programs, and to counteract the adverse effects of the international crises in the most vulnerable populations of the country." The remaining $300 million will be used as originally planned to finance social investment programs.

¶4. (U) The decrees included the issuance of up to $350 million in new debt to pay for the Fiduciary Certificates of Education, Social Peace, and Citizen Security. This "fidiecomiso" debt, set up under the Saca Administration when it failed to secure new international loans, was largely considered "toxic debt" by private investors and is mostly held by government-related institutions and pension funds.

¶5. (U) The Assembly also approved the issuance of up to $800 million in new debt to convert short term government Letters of Treasury ("Letes") into medium term debt. This debt will be incorporated into the 2009 general budget. They also approved the issuance of up to $653 million in new debt that will be used to pay the $650 million Eurobonds maturing in July 2011.

¶6. (U) On May 26, the government sold $300 million in Letes with a one-year term. The banking sector bought 87 percent of the total, or $260 million. These funds will be used to cover delayed payments to suppliers and other current budget expenditures. These Letes are eventually expected to be exchanged for longer term debt.

¶7. (SBU) COMMENT: The loan reallocation and new debt approvals are the first steps in addressing a 2009 budget deficit of at least $1 billion, caused by falling tax revenues and lingering expenses from the Saca Administration's untargeted subsidies for electricity, propane gas, and transportation. So far, the various International Financial Institutions, especially the IDB, appear willing to supply new loans, though exact terms and amounts remain under negotiation. END COMMENT.

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